

DEPARTMENT OF STATE REVENUE

LETTER OF FINDINGS NUMBER: 99-0093RST

Sales and Use Tax
For Years 1995, 1996, and 1997

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ISSUE**I. Use Tax – Imposition of Use Tax on Corn Receiving and Storage Facilities**

Authority: Ind. Code § 6-2.5-3-2;
Ind. Code § 6-2.5-5-30;
Ind. Admin. Code tit. 45, r. 2.2-5-10.

The taxpayer protests the imposition of use tax on its purchase of corn receiving and storage facilities.

II. Use Tax – Imposition of Use Tax on Lake Water In-Take System

Authority: Ind. Admin. Code tit. 45, r. 2.2-5-8;
Ind. Admin. Code tit. 45, r. 2.2-5-10.

The taxpayer protests the imposition of use tax on its purchase of pumping system equipment to bring lake water into its facility.

III. Use Tax – Imposition of Use Tax on Palletizing Equipment

Authority: Ind. Admin. Code tit. 45, r. 2.2-5-8;
Ind. Admin. Code tit. 45, r. 2.2-5-10.

The taxpayer protests the imposition of use tax on its purchase of palletizing equipment.

IV. Use Tax – Imposition of Use Tax on Propylene Oxide Tanks

Authority: Ind. Admin. Code tit. 45, r. 2.2-5-10.

The taxpayer protests the imposition of use tax on its purchase of propylene oxide tanks.

STATEMENT OF FACTS

The taxpayer is a Maine corporation doing business in Indiana. The taxpayer processes corn and produces various products including cornstarch, corn syrup, corn oil, and high protein animal feed. The taxpayer receives the corn by truck and by railcar. The corn is dumped through a grating onto conveyors. The grating removes some of the large foreign matter from the corn. At the end of the conveyors, the corn kernels are sprayed with mineral oil. After the spraying operation, the corn is carried by bucket elevators into large silos. From the silos, the corn is conveyed to milling areas where it is ground, refined, cleansed, and the kernels are separated into their various components. The taxpayer's products are passed through various filters, screens, and magnets to remove contaminants. The completed goods are bagged or loaded directly into railcars or trucks for shipment. Packaged products are palletized prior to shipment.

On November 10, 1998, a sales and use tax audit was completed. The taxpayer was assessed use tax on several items it had purchased. The taxpayer filed a timely protest and an administrative hearing was held on July 27, 2000. Additional information will be provided as necessary.

I. Imposition of Use Tax on Corn Receiving and Storage Facilities

DISCUSSION

The taxpayer was assessed use tax on equipment such as storage silos and grain conveyors. The taxpayer's position is that it began to process the corn it received when it sprayed the corn with mineral oil. The taxpayer claims that the mineral oil acts to trap dust onto the corn kernels thus increasing both the weight and nutritional value of the corn. The taxpayer also claims the mineral oil acts to reduce foaming during the production process. The taxpayer concludes the production process begins when it applies the mineral oil and therefore, equipment used after that point is exempt as equipment directly used in processing or refining. The taxpayer receives an environmental exemption for purchases of mineral oil and spraying equipment used for dust suppression purposes, pursuant to Ind. Code § 6-2.5-5-30. The issue before the Department now, however, is to determine the beginning of taxpayer's production process in order to properly characterize, for exemption purposes, certain "production" equipment.

"An excise tax, known as the use tax, is imposed on the storage, use, or consumption of tangible personal property in Indiana if the property was acquired in a retail transaction, regardless of the location of that transaction or of the retail merchant making that transaction." Ind. Code § 6-2.5-3-2(a).

- (c) Purchases of manufacturing machinery, tools, and equipment to be directly used by the purchaser in

processing or refining are exempt from tax; provided that such machinery, tools, and equipment are directly used in the production process; i.e., they have an immediate effect on the tangible personal property being processed or refined. The property has an immediate effect on the article being produced if it is an essential and integral part of an integrated process which processes or refines tangible personal property.

- (d) Pre-processing and post-processing activities. 'Direct use' begins at the point of the first operation or activity constituting part of the integrated production process and ends at the point that the processing or refining has altered the item to its completed form, including packaging, if required.

Ind. Admin. Code tit. 45, r. 2.2-5-10.

The auditor found that the production process began at the machine, known as the Texas Shaker, that acted to remove extraneous material from the corn, just before the corn was conveyed to steeping tanks where the kernels of corn are broken down. This point is after the mineral oil was sprayed on the corn.

The purpose of spraying the received corn with mineral oil is to suppress dust which can cause an explosion if ignited. The oil does not alter the corn nor does it become part of the final product. Therefore, the oil does not represent a raw material component of the taxpayer's products. Application of the oil is a pre-production activity for the purpose of suppressing dust. If, as the taxpayer claims, the mineral oil enhances the nutritional content of the corn to some degree by making dust stick to the kernels, it is an incidental and minimal effect.

The production process begins, as the auditor indicated, at the Texas Shaker machine, after the corn is sprayed with mineral oil. Therefore, the storage silos, conveyors, and any other equipment utilized by the taxpayer prior to the start of the production process are taxable.

FINDING

The taxpayer's protest is denied.

II. Imposition of Use Tax on Lake Water In-Take System

DISCUSSION

The taxpayer pumps large quantities of water, approximately 22,000,000 gallons per day, from Lake Michigan to be used in its plant. The water is pumped through underground pipes a distance of one half mile from the lake to the plant. The water is chlorinated and passes through several screens to remove water life and debris. The water is then pumped into a large well where it is temporarily stored for use in the plant's operations. The primary function of the water is to be cycled through heat exchangers to cool the taxpayer's manufacturing machinery. Some of the treated water is sent to boilers to provide steam to other machinery. Finally, some of the water is directly used in the production process by being mixed with the product itself. Excess water, and water not actually consumed in the production process, is treated and cycled into a smaller lake.

The auditor assessed use tax on the pumping system equipment based on how the Lake Michigan water was used in the production process. The auditor determined that 12% of the water used actually came into contact with the taxpayer's product during the processing operations. This water was treated as a raw material for use tax purposes and the remaining 88% was treated as a consumable. Therefore, the auditor exempted 12% of purchases associated with the pumping system equipment per Ind. Admin. Code tit. 45, r. 2.2-5-10, and assessed use tax on the remaining 88% of the purchases. The taxpayer protests the assessment, claiming that all of the pumping system equipment should be exempt under Ind. Admin. Code tit. 45, r. 2.2-5-8.

The state gross retail tax does not apply to purchases of manufacturing machinery, tools, and equipment to be directly used by the purchaser in the production process provided that such machinery, tools, and equipment are directly used in the production process; i.e., they have an immediate effect on the article being produced. Property has an immediate effect on the article being produced if it is an essential and integral part of an integrated process which produces tangible personal property.

Ind. Admin. Code tit. 45, r. 2.2-5-8(c).

This Administrative Code section contains several examples of exempt equipment:

(2) The following types of equipment constitute essential and integral parts of the integrated production process and are, therefore, exempt. The fact that such equipment may not touch the work-in-process or, by itself, cause a change in the product, is not determinative.

(C) Boilers, including related equipment such as pumps, piping systems, etc., which draw water, or produce and transmit steam to operate exempt machinery and equipment used in direct production.

....

(3) The following types of equipment constitute essential and integral parts of the integrated production process and are, therefore, exempt. The fact that such equipment is built in a manner to service various pieces of exempt equipment, as an alternative to building the equipment into each of the pieces of exempt machinery, is not determinative.

(A) Pumping and filtering equipment and related tanks and tubing used to supply lubricating and coolant fluids to exempt drilling and cutting machinery.

(B) Cooling towers and related pumps and piping used to cool, circulate, and supply water employed to control the temperature of exempt furnaces and exempt machines used in the foundry and machining areas.

Ind. Admin. Code tit. 45, r. 2.2-5-8(c)(2), (3)(A, B).

As shown in the above examples, the taxpayer's pumping system equipment qualifies as property that is an essential and integral part of an integrated process producing tangible personal property. To the extent that the pumping system equipment is used to supply water to exempt equipment, it is exempt. To the extent the pumping system equipment supplies water to non-exempt equipment, it is not exempt. Ind. Admin. Code tit. 45, r. 2.2-5-8(c)(3)(C). Use of the pumping system equipment to deliver water to heat exchangers to cool exempt equipment, to deliver water to boilers to produce steam for direct use in the production process, and to deliver water into the production process for inclusion in the product itself are exempt uses.

As determined in Part I of this Letter of Findings, the production process begins at the Texas Shaker machine. None of the machinery and equipment used prior to the start of the production process is exempt and any use of the pumping system equipment to deliver water to that machinery and equipment is taxable. Likewise, any use of the pumping system equipment to deliver water to other non-exempt machinery or equipment in the taxpayer's plant is taxable.

FINDING

The taxpayer's protest is sustained pursuant to the aforementioned language.

III. Imposition of Use Tax on Palletizing Equipment

DISCUSSION

The taxpayer protests the imposition of use tax on its purchases of palletizing equipment. The audit report found that the taxpayer's bags of corn products were palletized for shipping convenience. The auditor concluded that the palletizing operation was post-production and, therefore, taxable. In response, the taxpayer cites the example found in Ind. Admin. Code tit. 45, r. 2.2-5-10(c)(2)(D): "The exempt production process begins after the bottles are introduced onto the bottle conveyors for the filling step of production and ends with the final packaging of the product onto the case palletizers." The taxpayer maintains that palletizing of its bags of corn products is part of the integrated production process and, therefore, the palletizing equipment is exempt from use tax.

(c) The state gross retail tax does not apply to purchases of manufacturing machinery, tools, and equipment to be directly used by the purchaser in the production process provided that such machinery, tools, and equipment are directly used in the production process; i.e., they have an immediate effect on the article being produced. Property has an immediate effect on the article being produced if it is an essential and integral part of an integrated process which produces tangible personal property.

(d) 'Direct use in the production process' begins at the point of the first operation or activity constituting part of the integrated production process and ends at the point that the production has altered the item to its completed form, including packaging, if required.

Ind. Admin. Code tit. 45, r. 2.2-5-8.

Taxpayer has provided additional information to show that its palletizing operation is an adjunct to its manufacturing operations—and not to its shipping operations. As taxpayer explained, "...[the] palletizing operation is a continuous, uninterrupted, integrated production process that is only complete once the bagged items are wrapped and secured on a pallet. At that point the loaded pallets are taken from the production line to the shipping warehouse."

FINDING

The taxpayer's protest is sustained.

IV. Imposition of Use Tax on Propylene Oxide Tanks

DISCUSSION

The taxpayer protests the imposition of use tax on the purchase of propylene oxide storage tanks and associated connecting pipes. Propylene oxide is introduced into the production process and acts to enhance the characteristics of the corn starch produced by the taxpayer. The auditor found that the storage tanks were too far removed from the production process to qualify as exempt production equipment. The taxpayer focuses on a section of the Administrative Code to support its argument that the storage tanks and connecting pipes are exempt. “Component parts of an exempt unit of machinery and equipment, which unit has an immediate effect on the article being produced, are exempt if such components are an integral part of the manufacturing unit.” Ind. Admin. Code tit. 45, r. 2.2-5-10(g).

The propylene oxide tanks and pipes are not component parts of exempt machinery and equipment. The propylene oxide is a raw material used by the taxpayer to process corn starch. The purpose of the storage tanks is to contain the propylene oxide until it is needed for introduction into the production process. The relevant regulation is Ind. Admin. Code tit. 45, r. 2.2-5-10(e): “Tangible personal property used in or for the purpose of storing raw material . . . is subject to tax” The raw material, propylene oxide, does not act upon the taxpayer’s product until it is actually introduced into the production process. Storage tanks and connecting pipes for delivery of the raw material are pre-production equipment and subject to tax.

FINDING

The taxpayer’s protest is denied.